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RULSDMK/DEPT OF TRANSPORTATION WASHDC
RUEKJCS/SECDEF WASHINGTON DC
RUEAIIA/CIA WASHINGTON DC
RUCPDOC/DEPT OF COMMERCE WASHDC
RHMCSUU/DEPT OF ENERGY WASHINGTON DC
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¶1. (U) Summary: On May 24, risk analysis firm Economic Associates organized a seminar during which Lagos Business School Professor Doyin Salami offered an assessment of the current and medium-term macroeconomic climate in Nigeria. High global commodity prices have resulted in an export boom, and GDP growth has been fueled by growth in the non-oil sector, but this has not translated into higher disposable income and consumer spending. Salami argued the 2007 Federal Budget was contractionary relative to GDP, and provided inadequate investment in infrastructure, which would have negative multiplier effects on GDP. End summary.

¶2. (U) On May 24, risk analysis firm Economic Associates organized a seminar entitled "Medium Term Outlook for Nigeria". Lagos Business School Professor Doyin Salami offered an assessment of the current and medium-term macroeconomic climate in Nigeria. Salami highlighted non-oil sector growth; consumer and government spending; and the 2007 federal budget. Septel will discuss post-election investment climate, as presented by Country and State Risk Analyst, Economic Associates, Olly Owen. Below are some of the conclusions presented by the analysts.

Growth Is Fueled By The Non-Oil Sector

¶3. (U) The non-oil sector fueled growth of gross domestic product (GDP) in 2006. Nigeria benefited from high global commodity prices for oil, metals and agricultural raw materials. GDP growth was estimated at six percent for the last three years. Nearly half of the GDP growth in 2006 was attributed to crop production, while wholesale and retail trading contributed one-third of GDP growth. Telecommunications contributed one-twelfth, and manufacturing accounted for six percent of growth in GDP. During this period, GDP from oil contracted, in part due to reduced oil production.

Rise In Exports; Decline In Consumer Spending

¶4. (U) Exports, net exports, and investment grew steadily over the last three years. The Nigerian Export Promotion Council (NEPC) announced revenue of naira 40.8 billion from non-oil exports in the first quarter of 2007, almost double the naira 22.2 billion in 2006. At the same time, however, disposable income and private consumer spending have declined steadily. An increase in exports, triggered by strong upsurges in oil and non-oil commodity prices, has resulted in a government investment and spending "boom", according to Salami. Investments have been predominantly in infrastructure: in 2007, naira 830 billion was budgeted for capital expenditure, a 46 percent increase over the naira 569 billion budgeted in 2006. Federal Government expenditure also included election-related spending.

¶5. (U) Although exports and government investment have increased, the increased production reflected in double-digit non-oil GDP growth is not translating to increased disposable income or increased consumer spending. One reason for this is the reduction of subsidies on pump prices of petroleum products in the last five years. (Note: Most recently, the federal government lifted pump prices on fuel by 15 percent, when former President Obasanjo, on his last day in office, raised the price from 65 naira/liter to 75 naira/liter. End Note.) Additionally, disposable income and private consumer spending have fallen due to inflation (which peaked at 28 percent in 2005) in the face of public sector wage rigidity. (Note: National Pension Commission (PENCOM) Director General Muhammed Ahmad estimated Nigeria has 49 million workers. Of these, 4 million are in the public sector; 4 million are in the private sector; and 41 million are in the informal sector. End Note.)

¶6. (U) According to Salami, the decline in disposable income and private consumer spending might, in part, explain the weakness in manufacturing capacity utilization in the face of strong non-oil sector growth. This decline raises the risks facing manufacturers of demand-sensitive goods, and present a challenge to banks expanding consumer banking activities.

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2007 Budget: Revenue Contraction, Low Capital Spending
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¶7. (U) The 2007 Federal Budget contains projected revenue of naira 1.8 trillion, a benchmark oil price of USD 40 per barrel, and a spending allocation of naira 2.36 trillion (reftel). Contrary to the notion that the proposed federal revenue of naira 1.8 trillion in 2007 is expansionary, it is only 10.4 percent of the GDP and the lowest in real terms in the past ten years, Salami said. The oil price benchmark of USD 40/barrel adopted for the 2007 budget disconnects it from the reality of the USD 60/barrel expected in 2007. This peg, he argues, stifles the federal budget. Total federal spending is proposed to drop to 13.3 percent of GDP in 2007 from 15.1 percent in 2006. Salami argued this budget contraction will have an accompanying contractionary effect on the economy, making it difficult for real output to continue to grow at the current rate.

¶8. (U) The capital budget, which funds capital-intensive projects such as infrastructure, has declined from 15 percent of GDP in 1999 to 4.5 percent of GDP in 2006. As was the case in previous years, these capital-intensive projects are unlikely to be completed in 2007. (Note: Late passage of the budget is usually the cause of low capital budget implementation. In 2006, the loss of revenue from the 600,000 barrel per day drop in crude oil production due to militants' activities early in the year forestalled full capital budget implementation. As of August 31, 2006, naira 52 billion, or

71 percent, of appropriated capital budget for the Works Ministry for road construction and rehabilitation had been released, making later claims of full implementation doubtful). Meanwhile, recurrent spending, such as public-sector salaries, dropped from 10.6 percent of GDP in 2006 to 8.8 percent in 2007.

¶9. (U) Salami criticized the Government for holding most of Nigeria's reserves in low-interest savings abroad rather than in capital projects at home. Salami suggested that building a strong base in rail, gas and oil pipelines, and other infrastructure could provide a productive use for foreign reserves and provide Nigeria with the infrastructure needed to allow continued growth in the non-oil sector.

Comment

¶10. (U) Comment: The increase in non-oil sector growth, fueled largely by booming commodity prices and good harvests in a year of good rains, may stall if commodity prices soften or weather is less favorable. Investment in infrastructure - which would support the expansion of the manufacturing sector - is indeed fundamental, but at the moment it is not clear that Nigeria has institutions that can effectively create and manage infrastructure, which argues for a more incremental approach to pouring the billions in oil profits set aside in the Excess Crude account into potentially white elephant infrastructure projects. Further the account is also meant to operate as a stabilization fund to ease economic shocks from falling commodity prices or production. Critical to spending Nigeria,s oil windfall effectively will be the establishment of mechanisms of transparency and accountability, and better technical and managerial capacity in government agencies implementing projects and programs. End comment.
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